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IN THE

Supreme Court of the United States

October Term, 1953.

No. **455**

PHILIP WEISS,

Petitioner,

against

JAMES W. JOHNSON, Collector of Internal Revenue.

Petition for Writ of Certiorari to the United States Court of Appeals for the Second Circuit.

MORLEY S. WOLFE,
SAMUEL KALMANASH,
Counsel for Petitioner,
220 Broadway,
New York, N. Y.

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THE REPORTER COMPANY, INC., New York City—1953

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In the

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No.

Philip Weiss, Petitioner, against James W. Johnson, Collector of Internal Revenue.	

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

Petitioner respectfully prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit entered in the above-entitled case on August 19, 1953 (R. 423) affirming the judgment of the United States District Court for the Southern District of New York.

Opinion Below.

The District Court filed no opinion. The opinion of the Court of Appeals (R. 417-423) is reported in 206 F. 2d 350.

Jurisdiction.

The jurisdiction of this Court is invoked under 28 U. S. C. A., Section 1254 (1).

Question Presented.

In this family partnership test case there is presented the question which was expressly left undecided at the close of this Court's opinion in *Commissioner of Internal Revenue v. Culbertson*, 337 U. S. 733, where at page 748, this Court stated:

> "* * * No question as to the *allocation of income between capital and services* is presented in this case, and we intimate no opinion on that subject."*

This writ of certiorari is also sought to obtain a determination of the following questions:

1. Whether there was in 1942, 1943 or 1944, any legal requirement, in a bona fide partnership, for the partners' agreement to allocate the unknown future net income according to some objective legal formula as between partners' services and partners' invested capital? Also, if there were a loss, would the same formula be applied?

2. Whether the Commissioner of Internal Revenue may, after acknowledging the validity of a family partnership and where the division of profits is not wholly unreasonable, set aside the agreement of the partners and reallocate the income according to his own judgment between capital and services?

3. Whether this Court should resolve the conflict of opinion of the Court below (R. 417-423) with the Courts of Appeal in other circuits and the Tax Court of the United States? The latter Courts have held that where a family partnership is bona fide, the Commissioner and the Courts may not disregard the partners' own profit-sharing and salary arrangements.

4. Whether the meaning of "*Reasonableness of Agreed Division of Profits*" permits the substitution of *reason-*

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* All italics ours unless otherwise indicated.

ableness of return on capital invested, in construing Internal Revenue Bulletin Mim. 6767, 1952-1 Cum. Bull. 111,120 (R. 421-422).

Statement of the Case.

Petitioner and his three daughters and the family of one Henry Grubel were shareholders in a corporate textile business until December, 1941 (R. 13). Then, in December, 1941, a family partnership[1] was formed between the same stockholders, members of the two families, and it succeeded to the business of the corporation (R. 15).

On June 7, 1942, Grubel, actively associated with petitioner in the business for many years, suddenly died, causing a dissolution of the partnership (R. 16). Petitioner had devoted himself to the supervision of the out-of-town mills which produced the textile fabrics (R. 17, 18, 129). Grubel had been in charge of the New York office, which attended to sales of finished products, checking of customers' credit, pay roll, credit financing of the purchases, collection of accounts receivable and payment of bills (R. 142). Petitioner was ill and on in years (R. 36, 54, 124). Grubel's death required prompt affirmative action (R. 23). Petitioner weighed the possibility of continuing in business and he called upon members of his family (R. 132, 135), [illegible], after discussion, agreed with him to form a New York Limited Partnership (R. 23, 126, 131).[2]

Petitioner did not personally have the money to pay out the family of the deceased (R. 16, 93) and new partners and services (R. 23) were both urgently and speedily required. The capital investment of petitioner's three

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[1] Herein called the 1941 partnership or the Grubel-Weiss partnership.

[2] Herein called the 1942 partnership or the Weiss, Krosney and Sunshine family partnership.

daughters (R. 17, 20) amounting to $131,814.71, which they had acquired from their mother over twenty years prior, and from gifts from petitioner from time to time, not contemporaneous with or incident to the formation of this partnership, as well as from accumulations of earnings on their investments over the years, helped petitioner to pay out the Grubel family (R. 17, 20, 48, 49, 93, 339). His daughters' contribution of mill properties as part of their capital investment, when sold in 1944, accounted for $165,149.84 of the partnership profits (Pl. Ex. 6, Sch. G, Col. 8, R. 333).

Petitioners sons-in-law provided the needed services. Petitioner offered his lawyer son-in-law, Bernard Krosney, a 10 per cent interest (R. 132, 135) in the partnership if he would leave his own profitable manufacturing business (R. 22, 125) and come with him as a general partner, to help manage the business (R. 129). Petitioner also offered his accountant son-in-law, Samuel Sunshine, a five per cent interest in the partnership in order to induce him to remain with him in the management of the business as a general partner (R. 21, 141). Bernard Krosney and Samuel Sunshine each was offered, in addition to their partnership interests in profits or losses, a living expense drawing account of $7,500 per annum. Our country was at war and competent managerial services were at a premium and difficult to get. The new family partnership began on June 8, 1942, and ended in 1944.

Upon the death of Grubel in June, 1942, the books of the 1941 partnership had been closed and the profits up to June 7, 1942 (the date of Grubel's death) had been distributed among the partners. The succeeding 1942 family partnership, pooling the assets of the Weiss, Krosney and Sunshine families, began on June 8, 1942, closed its books at the end of the calendar year on December 31, 1942, and distributed the profits among the partners. Conse-

quently, petitioner had to report for 1942 his share of the profits from two separate and distinct partnerships.

Action of the Commissioner: Internal Revenue Agent Clines, in 1948, examined both the Grubel-Weiss 1941 partnership and the Weiss, Krosney and Sunshine 1942 partnership for the years 1942, 1943 and 1944. He made changes in the distribution of net partnership income among the partners, for both partnerships. None of the partners of the Grubel-Weiss 1941 partnership protested the Commissioner's findings of fact or the changes made in the partnership return of the distribution of net income among the partners as to that 1941 partnership because the additional taxes, which were assessed and duly paid, were considered trifling and Grubel had died. The Commissioner did not assert at any time that there were other taxes due and unpaid arising from that partnership. Petitioner's claim for refund and his complaint were clearly directed at the 1942 partnership and his request for judgment was as to the tax assessed on the revised distribution of that partnership's profits. Though the total of petitioner's 1942 income was in issue, he raised no issue as to that part which he derived from the 1941 partnership. However, there was a question of principle at stake as to the 1942 partnership and whatever money judgment was sought would result from its proper decision (R. 2-6).

Petitioner objected to the reallocation of the partnership income of the 1942 partnership for the years 1942, 1943 and 1944 (R. 342-345). The report of Revenue Agent Clines was made after reviewing the services rendered by all the active general partners, including petitioner, Bernard Krosney, and Samuel Sunshine, and the limited partner, Beatrice Weiss. The report also shows that with respect to the two non-working partners, Helen Sunshine and Miriam Krosney, their capital contribution was sub-

stantial and did not originate as an incident to or contemporaneous with the formation of the partnership (R. 93, 339). Petitioner paid the tax to avoid interest charges, filed his claim for refund and, when the claim for refund was not allowed, commenced suit.

The following table shows the capital contribution of the various partners at the formation of the 1942 partnership, as well as the distribution of profits per the agreement, and as per the reallocation of the Commissioner, and reflects the percentage change made:

General Partners	Capital Invested[3] At the Beginning		Profit Sharing Per Agreement[4]	Per C. I. R.[5]
Philip Weiss	$202,746	59.6%	40%	58%
Samuel Sunshine	3,000	.9	5	2
Bernard Krosney	3,000	.9	10	2
Limited Partners				
Beatrice Weiss	65,957	19.4	20	19
Helen Sunshine	43,957	12.9	15	13
Miriam Krosney	21,900	6.3	10	6
	$340,560[6]	100. %	100%[7]	100%[8]

[3] (R. 398, Ex. O) Cents omitted.

[4] (R. 398, Ex. O) After salaries to Samuel Sunshine and Bernard Krosney of $7,500 each and $20,000 to petitioner.

[5] (R. 379, Ex. I) After increase of salaries to Samuel Sunshine and Bernard Krosney by Commissioner to $15,000 each and disallowance of salary to petitioner.

[6] (R. 338.)

[7] (R. 339.)

[8] (R. 340.)

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Specification of Errors to be Urged.

Petitioner submits that the Court of Appeals erred:

I. By ruling in the instant case, of a concededly bona fide family partnership, where the agreed division of profits was not wholly unreasonable, that the Commissioner had the power to disregard the agreed profit-sharing and salary arrangements of the partners, contrary to the decisions of the Courts of Appeal of other circuits and the Tax Court of the United States.

II. By interpreting Section 7 of Mim. 6767, 1952-1 Cum. Bull. 111,120 (R. 421) so as to make the test not the *"Reasonableness of the Agreed Division of Profits"* for each partner at the formation of the partnership as therein provided, but instead substituting a test of *"return on capital invested,"* looked at retrospectively after the year end.

III. By affirming the judgment of the District Court.[9]

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[9] We reserve the following specifications of error to be urged on appeal in the event this writ of certiorari is granted:

(a) Admission of opinion testimony on the question of "return on invested capital" when such a basis had no bearing on partners' agreement to share profits and losses.

(b) Did the Trial Court commit reversible error in permitting the introduction of Exhibits P, Q and R (R. 404-411)?

(c) Did the Court commit reversible error by making the 1941 partnership an issue in this case?

(d) If decision of this Court in the *Culbertson* case of what was left undecided therein permitted allocation of profits between use of capital and services, then a retrial of this case should have been ordered as in *Gowran v. C. I. R.*, 7 Cir., 87 F. 2d 125, 127, aff'd 302 U. S. 238, 245.

(e) The Court in permitting the jury to reallocate profits between capital and services delegated to it powers which by law only the Commissioner has.

(f) The Courts below were influenced by I. R. C. Sec. 191, added by Sec. 340 (B) of the 1951 Act, without distinguishing between a gift of a partnership interest and where a partnership is based on new capital or services contributed.

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Reasons for Granting the Writ.

A. The undecided question in C. I. R. v. Culbertson, 337 U. S. 733, and conflict of circuits.

This case presents issues concerning a bona fide family partnership requiring a determination by this Court of the question it expressly left undecided in *C. I. R. v. Culbertson,* 337 U. S. 733, at p. 748, and about which the decisions of the various Circuit Courts of Appeal are in conflict.

In the present family partnership case, the very question is presented. The Court below stated, "Here we have to deal not so much with the existence of such a partnership, but with the distribution of its income among its members * * *" (R. 417). The existence of a valid partnership was established by the uncontradicted testimony of a contribution by all of the partners of either needed capital or vital services, or both. The Commissioner of Internal Revenue presented his case as a test of *his power to reallocate partnership profits contrary to the agreement of the partners.* The Courts of Appeal of other circuits have held that the Commissioner does not have the power to disregard agreements of partners (who are in the best position to know their relative worth to the business at the inception of the partnership), and to substitute instead the Commissioner's judgment as to the allocation of profits in after years when a profit and not a loss has been established. *Marcus v. C. I. R.,* 5 Cir., 201 F. 2d 850, 853; *Woosley v. C. I. R.,* 6 Cir., 168 F. 2d 330; *Hartz v. C. I. R.,* 8 Cir., 170 F. 2d 313.

However, as long as there existed a conflict among the various circuits, the Commissioner's claim of power continued respecting the reallocation of income between capital and services in a bona fide partnership, and especially

since the Court below agreed with him regarding the Culbertson statement, at p. 748, as lending support to the language of his own Mim. 6767, 1952-1 Cum. Bull. 111, 120 (R. 421).

An examination of the facts in the present case in the light of this Court's decision in *C. I. R. v. Culbertson,* 337 U. S. 733, and the decision of the other circuits holding that the partners' agreed division of profits is to be respected will indicate that the principle of *Gowran v. C. I. R.,* 7 Cir., 87 F. 2d 125, 127, aff'd *Helvering v. Gowran,* 302 U. S. 238, 245, referred to by the Court below, is inapplicable.

The Sons-in-Law: The Court below noted the fact that "the responsibility of the operations and management rested upon the two general partners Bernard and Samuel" (R. 419). The Commissioner saw fit to increase their salaries from the $7,500 the partners had agreed on, to $15,000 each per annum, thus recognizing the value of the contributions made by their services to the partnership income (R. 340). Bernard and Samuel did not enter into the partnership looking for jobs or salaries. They worked and they risked their credit for the partnership profits. Their agreed partnership interests should not have been disturbed only because their capital contribution was small. It was their services and their good business experience which contributed substantially to the earnings of the new partnership (R. 129, 130, 140). *Greenberger v. C. I. R.,* 7 Cir. 177 F. 2d 990. Under the circumstances, and since it could not be foretold at the formation of the partnership whether there would be profits or losses, can it be said that these minimum drawing accounts of $7,500 per annum and the offer to Bernard Krosney and Samuel Sunshine, respectively, of a 10 per cent and a 5 per cent interest in the profits or losses, were unreasonable? Strangers would have driven a harder bargain at the time.

In order to invoke his alleged power to reallocate profits of a valid partnership among its members, the Commissioner cited as authority Sec. 7 of Mim. 6767, 1952-1 Cum. Bull. 111, 120 (R. 421). The temptation to twist the language by substituting the test of "Return on Capital Invested" in place of "Reasonableness of Agreed Division of Profits" suggested itself to the Commissioner because the return to some of the partners based upon their capital contribution was high. It was this preoccupation with the misleading interpretation of Mim. 6767 which opened the door at the trial to the admission of irrelevant opinion testimony on "a return on invested capital" and in the form of the many exhibits of the Commissioner, more particularly Exhibits P, Q and R (R. 401-411). Thus, statistics were erroneously submitted to the jury reflecting fantastic percentages of return on the purely *token* capital contributions made by Samuel Sunshine and Bernard Krosney, the two valuable business managers who had contributed so much to the profits of the business, as follows:

	1942	*1943*	*1944*
Bernard Krosney	1280.33%	958.59%	1061.20%
Samuel Sunshine	640.15%	479.29%	530.60%

Exhibit P (R. 402-404), in which the above percentages were shown, was admitted on the theory that the apparently exorbitant percentages reflected a donative deflection of income on the part of petitioner to his sons-in-law and family. The effect was to deprive Samual Sunshine of 3 per cent, and Bernard Krosney of 8 per cent, of the profits, and add the total of 11 per cent to petitioner's taxable share of the partnership profits. This reallocation ignored the fact that Krosney and Sunshine had helped create the very income which they shared and presupposed that petitioner had made but a futile

gift. Supposing they had contributed no capital at all, how could the percentages of profits then be related to capital investments? In their case, their services alone sufficed to make them valuable partners. *C. I. R. v. Culbertson*, 337 U. S. 733.

Miriam and Helen: The decision of the Court below states (R. 418): "The issue centers particularly about the shares of partnership income allocated to the daughters Miriam and Helen, who contributed only capital, not services, and appeared to be receiving *an unusual return on their capital investment.*" In so stating the Court below erroneously gave undue weight to the fact that Miriam and Helen contributed only capital because this Court in *C. I. R. v. Culbertson, supra*, clearly stated that a contribution of either capital or services was sufficient to support a valid partnership.

The Courts below were in error in approving the introduction of Exhibit Q (R. 405-409), which allowed Miriam Krosney and Helen Sunshine a 10 per cent return (which figure was culled from thin air) for the use of their capital and in allocating the remainder to petitioner. *Dorzback v. Collison*, 3 Cir., 195 F. 2d 69 (1952); *Forman v. C. I. R.*, 9 Cir., 199 F. 2d 881 (1952).

Helen and Miriam alone brought $65,857 into the business, or 19.2 per cent of the total capital, a very substantial part of the capital which was desperately needed. The partners agreed that Miriam and Helen were to receive 15 per cent and 10 per cent respectively, or a total of 25 per cent share in the profits or losses. Considering that the business was the manufacturing of textiles for the ladies' apparel industry, a notoriously speculative business; considering that an experienced and valuable partner had just died and had to be replaced; that the remaining senior partner was ill and felt he was getting

on in years; the hurried action required to preserve the continuation of the business; and all these factors together, it is clear that the shares in the profits or losses given when the partnership was formed to these two, Helen and Miriam, were not unreasonable. The difference between their capital contribution and their agreed share was but 5.8 per cent. Strangers might have driven a harder bargain. The fact is that the Commissioner took $32,660 from the shares of profit of these two for the years 1943 and 1944. Yet the mill properties alone (aside from cash) which Miriam and Helen, together with their sister, Beatrice, contributed to the partnership, brought $165,149 (R. 271) of profits when the mills were sold in 1944 (Pl. Ex. 6, Sch. G, col. 8, R. 333), and the petitioner benefited by receiving his 40% partnership share.

The Court below described the changes made by the Commissioner in the shares of the two sons-in-law as "slight" (R. 419). The changes for them totaled 11 per cent. It logically follows that the changes made, reducing the percentages of Miriam and Helen by a total of only 6 per cent (Miriam 4 per cent and Helen 2 per cent), were less than "slight." And since, according to Sec. 7 of Mim. 6767, 1952-1 Cum. Bull. 111, 120 (R. 421), only "A *wholly* unreasonable agreement as to the sharing of partnership income *may* be evidence of the absence of bona fide partnership intent * * *," it follows that an agreement among partners as to the sharing of profits or losses reflecting so small a difference from what the Commissioner seeks to establish as to amount to less than "slight," should not be disturbed.

Beatrice: The Court below comments that "Although Beatrice gave her full time to the business she * * * was paid no salary" (R. 419). Beatrice's timely investment of needed capital was 19.4 per cent of the total capital of the business. The Commissioner considered capital to be the important factor (R. 419). In view of this capi-

tal contribution and her full time devoted to important managerial functions without pay, surely the partners' agreement to allow her an additional 6/10ths of 1 per cent, making her partnership interest in the profits or losses 20 per cent, was not unreasonable. Without question, a stranger might have driven a harder bargain.

In the present case, the agreement for the division of profits was made between the partners after they had thoroughly debated the equities and bargained at arms length. The business purpose is unquestionable. Each partner contributed something vitally needed and gave up something of great value. Petitioner, Krosney and Sunshine were all married and each family group depended on its respective shares of the profits for their existence. The great good fortune of the three families working together as partners is aptly described in *Ardolina v. C. I. R.*, 186 F. 2d 176, at p. 182, where the Court said:

> "* * * All of the evidence compels the conclusion that the Ardolinas' * * * entire married lives down to the particular time in question naturally and honestly led up to the formation of their * * * partnership. The evidence leaves no doubt of their good faith in entering into that arrangement. *The astounding success of the partnership, under the family regime does much to justify the avowed business purpose of the partnership,* namely by the Ardolinas' joint present conduct of the enterprise to insure its sound operation * * *."

The Court below relied on its own decision in *Sommers v. C. I. R.*, 2 Cir., 193 F. 2d 609, Reh. 195 F. 2d 680, where it "inferentially recognized" (R. 421) the taxing authority to have the power of reallocation of profits. But the facts in *Sommers v. C. I. R., supra,* were different because there a sub-venture existed between husband and wife.

Furthermore, the question involved in *Sommers v. C. I. R., supra,* and the present case were also involved in the cases decided contrariwise by the Courts of Appeal in other circuits, and hence there is a direct conflict of opinion. We believe that the weight of law is with the other circuits.

In *Marcus v. C. I. R.,* 5 Cir., 201 F. 2d 850, at p. 853, the Court said:

> "Particularly is it true that it was not for the commissioner and the Judge to substitute their ideas for what the partners ought, in creating the partnership, to have provided in respect to sharing its profits. This, as the Supreme Court, in the *Culbertson* case, and we, in later cases, have pointed out, was for the determination of the partners if made by them in good faith, that is as a reality and not as a sham."

In *Woosley v. C. I. R.,* 6 Cir., 168 F. 2d 330, the Court at pp. 332-333 held:

> "The partnership agreement did not provide, as the tax tribunal inferred, that the profits of the partnership were to be divided *in proportion to the capital contributions of the partners.* The sharing of profits and losses, according to the express provision of the agreement of May 26, 1937, which was continued and confirmed by the last agreement of December 30, 1939, *was to be in proportion to the interest of each of the partners in the partnership.* * * * It is obvious that the parties did not contemplate compensating themselves in full by the payment of salaries, but that *each expected to receive, in addition to his or her salary, the specified division of profits.*"

In *Hartz v. C. I. R.,* 8 Cir., 170 F. 2d 313, at p. 318, the Court stated:

> "* * * From these cases and the many other reported cases on the subject we understand the rule

> to be that if the facts disclose a real bona fide partnership, it may not be disregarded for tax purposes. * * * Our difference arises from a failure by the Tax Court to find and give due deference to the uncontroverted evidence that this partnership was created in good faith for the purpose of obtaining necessary working capital to insure the continued existence of the business. We find no justification for a conclusion that this was a sham or a device to avoid the payment of taxes. Concluding, as we have, that this record compels the conclusion that this was a valid partnership, the Tax Court had no right to reapportion the income of the partnership between the partners for tax purposes."

Other cases holding the Commissioner may not substitute his judgment for the parties' where the agreement is valid, are *Canfield v. C. I. R.*, 6 Cir., 168 F. 2d 907, 913; *Delchamps v. C. I. R.*, 13 Tax Court 281, 287. See: Taxes, Vol. 25, Number 11, pp. 963, 970 (Nov., 1947).

In *Dorzback v. Collison*, 3 Cir., 195 F. 2d 69 (1952), a wife loaned $8,500 to her husband's business on a promissory note bearing interest at 5%. Two years later, they agreed that if she accepted in place of her note a different sort of bond, which subordinated her claim to the claims of other creditors, the business would pay her in lieu of interest a sum equal to 25% of the business profits after a salary to the husband of $4,000 per annum. The Commissioner disallowed this deduction of 25% of the profits to the husband because, he said, as an interest payment it was larger in amount of dollars than the debt itself and it was so unreasonable as to be tantamount to a subterfuge for the reallocation of business profits. The debt to the wife was not denied. The Court, at page 72, said:

> "Throughout the ages lenders have exacted all they could from borrowers for the use of money.

> How much has been exacted has depended on the desperation of the borrower and the exigency of the moment. There is no requirement in Section 23 (b) that deductible interest be ordinary and necessary or even that it be reasonable. * * *"

To the same effect, see *Forman v. C. I. R.*, 9 Cir., 199 F. 2d 881.

B. The novel, irrelevant and impracticable test of "Return on Capital Investment" as an element in partnership agreements, if approved by this court may well become a form of judicial legislation.

Interference by the Commissioner or by the Courts with contracts made in good faith should not be encouraged. In the language of Mim. 6767, 1952-1 Cum. Bull. 111,120 (R. 421), the Commissioner made "Reasonableness of Agreed Division of Profits" a test of bona fide partnership intent. Where such contracts are "wholly unreasonable," we can follow the reasoning which declares the partnership invalid. A partnership which is "partially invalid" (R. 422) so as to reject as partners some of the members because of some test approved in the reasoning of this Court's decision in *C. I. R. v. Culbertson*, 337 U. S. 733, is also understandable. If a valid partnership exists, but the partners' agreed division of profits does not coincide with the Commissioner's ideas (R. 417), then the Commissioner should not be permitted, by substituting the test of *Reasonableness of Return on Capital Invested*, to twist the plain meaning of his own Mim. 6767, 1952-1 Cum. Bull. 111,120, which, in providing a test of bona fides, reads, in part:

> "7. Reasonableness of Agreed Division of Profits —Allocation. A *wholly* unreasonable agreement as

> to the sharing of partnership income may be evidence of the absence of bona fide partnership intent * * *."

In the first place, prospective partners do not generally have the gift of prophecy and, hence, cannot foresee whether the business will result in either a profit or a loss. It also follows that they do not agree when they join together in a business venture, to be paid "a return on invested capital," since there may be no profits at all, and possibly no capital left either. How would the Court below have reconciled its decision in *Sommers v. C. I. R.*, 2 Cir., 193 F. 2d 609, Reh. 195 F. 2d 680, if the partnership had sustained a loss for the year in question?[10] Therefore, when Internal Revenue Bulletin Mim. 6767 speaks of "Reasonableness of Agreed Division of Profits" or sharing of partnership income, it does not mean *Reasonableness of Return on Invested Capital.* The test is as to the agreed division of profits or losses, spoken of at the formation of the partnership, and not after the year end or years later upon the Commissioner's examination of the income tax returns and the profitable results are an established fact.

The Court below refers to a donative scheme or deflection of income by petitioner, which is negatived by the fact that petitioner had only a 30% interest in the profits of the 1941 Grubel partnership, together with a salary of $12,000 per annum as compared with a 40%

[10] "The Allocation Theory in Family Partnership Cases," appearing in the November, 1947, issue of "Taxes," Vol. 25, Number 11,963 at page 969, in discussing *Canfield v. C. I. R.*, 6 Cir., 168 Fed. 907, raises the question that if $7,500 of the profits were attributable to Mr. Canfield's personal services and if, instead of a gain, there had been a loss, would the Court have held that the value of his services were a minus $7,500.

interest in the instant partnership, together with a salary of $20,000 per annum (R. 19). Furthermore, had this partnership been an artificial creation at the whim of petitioner, the capital contributions might well have been adjusted at the beginning so as to conform with the shares in the profits which each partner was to enjoy.

The Revenue Acts[11] provide for the keeping of records reflecting the business gross income and deductions. The instant partnership kept the records provided by law and the facts disclosed were verified correct by Internal Revenue Agent Clines.

C. Allocation of profits between capital and services.

At the trial below, the Commissioner attempted to find factual evidence to support his proposed reallocation of partnership income between capital and services, by opinion testimony exacted from petitioner under protest (R. 54, 55, 56, 57, 60, 61, 62). Petitioner was not prepared, nor did he believe it was possible, to voice fair or reliable opinion as to what portion of the profits was attributable to capital and what to services. Nor was the Commissioner aided by the alleged expert testimony of Internal Revenue Agent Clines, who discredited his own testimony by stating that he had merely followed Bureau policy and had prepared the offered exhibits as instructed, to serve as mathematical calculations (R. 267); that they did not represent his opinion because in the seventeen years that he had been in the Internal Revenue Service, during which time he had examined about ten partnerships each year, he had never seen a partnership agreement provide for return on invested capital rather than a percentage division of the profits (R. 180, 256).

[11] Int. Rev. Code Secs. 181-183, 26 U. S. C. A. Secs. 181-183.

Petitioner cannot agree that it is practicable or possible to allocate correctly in advance the profits of his business between the value of the services of the partners and their invested capital, bearing in mind the many other contributing causes to the ultimate profits of his business—or, for that matter, in the case of any other manufacturing business. It is difficult to foresee at the formation of a partnership the extent to which each partner's services actually will contribute to the partnership earnings.[12]

In the present case, it is especially fruitless to speculate about the allocation of profits because on the very face of things, when we examine the partners' agreement for the percentages which they agreed upon among themselves and compare them with what the Commissioner allowed, it becomes apparent that no such *wholly unreasonable division* appears as would justify meddling with the partners' agreement.

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[12] The fixing of salary accounts is a matter of bargaining. The business net profits are the result of effort on the part of management and many employees on a salary basis and salespeople on a commission basis. Business profits may result from fortunate purchases, from an extraordinary state of the times (like a war period), or from an exclusive agency to represent the producers of a branded or special product, like a formula or patented item which gives the business a legal monopoly. And no matter how many other situations which one can think of and describe, there are still other explanations possible of how the profits of a business could happen beyond the efforts of the partners and beyond the invested capital. It is therefore useless and unprofitable to pursue the attempt to separate business profits into the contributing sources at the inception of the partnership, when none can foresee what events will favor capital and which circumstances will cause one partner to produce more profits than another. In the final analysis the partners must decide after bargaining with each other.

D. The questions in this case are of nation-wide interest.

The questions herein presented are involved in numerous cases now pending before the Internal Revenue Service and the Courts. Neither the Revenue Acts of 1948 and 1951, nor *Commissioner v. Culbertson*, 337 U. S. 733, settled all the vexing questions arising in family partnerships. By the 1948 Law, married taxpayers computed their taxes by dividing their income in half, computing the tax according to the rate applicable to the halved income, and then doubling it to reach the tax payable. This settled the tax dispute in husband and wife partnerships. However, there still remain partnerships between ancestors and descendants and brothers and sisters, etc. The 1951 Revenue Act does not settle their difficulties.[13] There are cases as between ancestors and descendants where the capital contributed by the donee or vendee partner was not received as a gift incident to or contemporaneous with the formation of the partnership. And brothers and sisters, and brothers and sisters-in-law, or sons and daughters-in-law, do not fall within the definitions expressly stated in the Act (family includes only spouse, ancestors and lineal descendants).

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[13] The Court below in its footnote (R. 422) indulges in reflections concerning the effect of the 1951 Revenue Act (I. R. C. Sec. 191 added by Sec. 340 [b] of the 1951 Revenue Act). Apart from the irrelevance of this observation, it is incorrect. The very purpose of the act was not to look to the source of the gift but rather its reality. The gifts in the present case were not made incident to or contemporaneous with the formation of the instant partnership (R. 339) and not all of the daughters' capital contributions originated as gifts from petitioner (R. 48). Even if it were applicable, the 1942 partnership agreement provided for a salary to petitioner of $20,000 before a division of profits consonant with this statutory enactment which the Commissioner ignored. See example in Vol. 3, C. C. H., 1953 Fed. Tax Rep., Par. 1186F, p. 16136.

CONCLUSION.

For the foregoing reasons, we respectfully submit that this petition should be granted.

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MORLEY S. WOLFE,
SAMUEL KALMANASH,
Counsel for Petitioner.